

VZCZCXYZ0002
OO RUEHWEB

DE RUEHSG #0982/01 3091951
ZNY CCCCC ZZH
O 041951Z NOV 08
FM AMEMBASSY SANTIAGO
TO RUEHC/SECSTATE WASHDC IMMEDIATE 3915
INFO RUCNMER/MERCOSUR COLLECTIVE IMMEDIATE
RUEHBO/AMEMBASSY BOGOTA IMMEDIATE 2154
RUEHME/AMEMBASSY MEXICO IMMEDIATE 1260
RUEHQT/AMEMBASSY QUITO IMMEDIATE 1963
RUCPDO/DEPT OF COMMERCE WASHDC IMMEDIATE
RUEATRS/DEPT OF TREASURY WASHDC IMMEDIATE

C O N F I D E N T I A L SANTIAGO 000982

SIPDIS

TREASURY FOR SSENICH
COMMERCE FOR KMANN
STATE PLEASE PASS TO USTR KATE DUCKWORTH
STATE PLEASE PASS TO FEDERAL RESERVE TOM CONNORS
STATE FOR WHA/BSC, WHA/EPSC, EEB/IFD/OMA

E.O. 12958: DECL: 11/03/2018
TAGS: [ECIN](#) [ECON](#) [EFIN](#) [EINV](#) [ETRD](#) [PGOV](#) [PREL](#) [CI](#) [XR](#)
SUBJECT: FORMER CHILEAN CENTRAL BANK GOVERNOR CORBO
CONFIDENT ON CHILEAN ECONOMY, MORE WORRIED ABOUT REGION

REF: SANTIAGO 976 AND PREVIOUS

Classified By: Ambassador Paul E. Simons. Reason 1.4 (b) and (d).

SUMMARY

¶1. (C) Vittorio Corbo told Ambassador Simons October 30 he is confident Chile can withstand the global financial crisis, although there will be a significant impact on the real economy. The Central Bank had built up reserves that could act as a cushion, foreign denominated debt was low, and the depreciating peso could open up opportunities for export growth. Chile was experiencing a credit squeeze and unemployment would reach double digits in 2009. Corbo hoped that Chile's absence from a list of countries to which the Federal Reserve had just extended swaplines would not impact confidence in the nation's economy. He advocated counter-cyclical spending and educational reform. Corbo assessed the health of regional economies, noting his worries about Argentina and to a lesser extent Peru. End Summary.

¶2. (U) The Ambassador met with Vittorio Corbo, a former Central Bank Governor under President Lagos (2003-2007) and World Bank economist, to review the current state of Chile's economic and financial stability, in light of the global financial crisis (reftels). The Ambassador was accompanied by Senior Econoff.

Reserves And Low Foreign Debt Can Help Chile

¶3. (C) Corbo underlined the GOC had made good decisions entering the current financial crisis. Although there would be a significant impact on the economy (he predicted GDP would grow by only 1-3% in 2009), Chile would weather the turmoil. The Central Bank had accumulated significant U.S. Dollar reserves (over \$24 billion) at the right time (i.e., just before the crisis). Those reserves could now act as a "cushion" for the Chilean economy. Corbo estimated foreign denominated debt in Chile at only \$37 billion, which was almost exclusively private sector, with maturities comfortably spaced over the next several years. He foresaw no problems for Chile's banks and blue chip corporations to roll over most upcoming debt maturities.

Depreciating Peso Not Unusual

¶4. (C) Corbo noted that although the Chilean Peso had depreciated dramatically against the U.S. Dollar in the past month (from approximately 553 to 677 in October), this was not unusual for a "commodity country." Corbo asserted that as commodity prices fell, other large, commodity exporting economies (such as Australia and New Zealand) had also seen significant depreciations in their currencies. He intimated that the Chilean Central Bank and Ministry of Finance might even consider moving some of their external portfolio back to Chile to take advantage of cheaper investments. Peso depreciation would create interesting opportunities for non-traditional export growth.

Crisis Causing Credit Squeeze and Unemployment

¶5. (C) According to Corbo, international institutions had cut some lines of credit to Chilean banks (and international buyers had cut credit to exporters) as a result of the financial turbulence. (Note. This contradicts Central Bank Governor De Gregorio's assertion that no lines of credit had been severed (see ref).) He noted there was definitely a "squeeze on the credit side" in Chile. Most of this he attributed to tighter commercial credit terms from importers.

¶6. (C) The global turmoil would also likely cause higher unemployment, which Corbo predicted could reach 10-11% in ¶2009. He said the consensus among Chilean economists was that increased flexibility was needed in labor markets (e.g., reducing severance payments). Corbo believed the crisis

afforded Chile a unique opportunity to effect this needed change. The Ambassador noted the OECD would be making a similar recommendation for labor market reform to the GOC as part of its accession process.

Worried About Chile's Absence From Fed Swaplines

¶7. (C) Corbo was concerned about how foreign investors in Chile and segments of the domestic economy would react to the Federal Reserve's announcement October 29 that Brazil, Mexico, South Korea, and Singapore would receive swaplines of up to \$30 billion each. He understood the justification for such an arrangement (though he was puzzled by Singapore's inclusion). Corbo felt Chile was conspicuously absent from the list and hoped this would not reduce confidence in the strength of the Chilean economy.

Counter-Cyclical Spending Needed

¶8. (C) The Ambassador asked about the effect recent declines in copper prices would have on the GOC's fiscal situation. Corbo was dismissive of the development, noting the Ministry of Finance had exercised impressive fiscal responsibility during copper's boom years. He said there was no need to cut back on spending now that copper prices were falling. The GOC had saved in the past, now was the time to implement counter-cyclical spending to help Chile surmount the impact of the global financial crisis.

¶9. (C) Corbo explained that the Chilean Congress would not be an obstacle in the budget process, as it could only reject or lower Government spending, not raise it. Only the executive branch could initiate spending. He added that unlike in the U.S., members of Congress did not have knowledgeable staff. The Ambassador noted that Congress relied heavily on think-tanks, such as Libertad y Desarrollo (center-right), for staff support.

Profound Education Reforms Will Be Critical

¶10. (C) Corbo called Chile's education system a "big problem" and one caused more by lack of direction than lack

of resources. The nation required innovation to sustain growth, which in turn necessitated development of human capital. He said all of Chile's previous governments had failed in this regard. The Ambassador noted there appeared to be a growing national consensus on the need for educational reform. Corbo agreed but said unions in the education sector were powerful, which was an impediment to adopting and implementing a reform program.

¶11. (C) Corbo explained that even subsidized primary and secondary education in Chile was failing because subsidies were often insufficient to improve the quality of education at a given institution. He opined that Chile had a "classist system" that needed to be rooted out at its foundation (i.e., in school). The GOC's recent announcement of a bicentennial scholarship program would help enrich the education of graduate students, but it ignored younger students. The Ambassador noted the majority of students in Chilean universities were first generation and asked whether this was a sign of success. Corbo acknowledged the fact, but noted that quality needed to be improved at many of the new for-profit universities.

Pessimistic About Argentina

¶12. (C) In response to the Ambassador's query about the economic situation in Argentina, Corbo said he was "very pessimistic." He considered Argentina, Ecuador, and Venezuela most vulnerable to the effects of the financial crisis. Corbo noted that although growth was temporarily high in Argentina, so was inflation. He explained the GOA had spent all its windfall profits from commodities, which were now seeing significant price declines (e.g., soy). There were also far too many subsidies costing the government

far too much (e.g., untargeted energy subsidies). Corbo pointed out that the prospect of a nationalized pension system was creating capital flight to Uruguay.

¶13. (C) The Ambassador asked how large, Chilean retail investors were faring in Argentina. Corbo highlighted the problems of increasing corruption, lack of investment in infrastructure, and price controls. Corbo explained these factors and previous experience in Argentina had taught Chilean companies to avoid cross-border risk. As a result, they raised capital in Argentina, paid salaries there, and generally tried to compartmentalize operations. These steps would shield Chilean investors from risk but at the cost of no new investments.

Prospects Better in Brazil, Mexico, and Colombia

¶14. (C) Corbo said if he had to choose a country to be in during the current crisis, "I want to be in Brazil." Brazil had wisely used revenue from high commodity prices, it was developing a strong middle-class, and it had recently discovered significant oil deposits. These factors augured well for weathering the global financial turmoil and for a strong economic recovery. Corbo expressed more doubt about Mexico. He was impressed with President Calderon and his efforts to solve Mexico's energy concerns, but the internal security situation was disturbing. Corbo was also impressed with the economic changes President Uribe had brought to Colombia.

Doubts On Peru

¶15. (C) Corbo doubted Peru could sustain its current high growth rates. He was impressed with President Garcia's continuation of pro-market reforms begun under former President Fujimori. However, greater efforts needed to be made on poverty reduction. Corbo believed the GOP was still waiting for trickle-down policies to work. The Government needed to spend more on directed subsidies in the inner provinces where there was a higher prevalence of poverty.

Directed subsidies and targeted infrastructure (such as rural electrification) were critical to Chile,s successful efforts to cut poverty.

SIMONS